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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 489

ROLAND P. PLACE,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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To The Honorable Fred M. Vinson, Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The petitioner, Roland P. Place, by Robert M. Drysdale, his attorney, respectfully petitions this Honorable Court for a Writ of Certiorari to review a judgment of the United States Court of Appeals for the Sixth Circuit rendered in the above cause.

OPINION BELOW

No opinion was rendered by the Court of Appeals, except that it affirmed the decision, findings of fact and conclusions of law of the Tax Court of the United States, which appear in 17 T. C. 191, and in record pages 101, 109 in this case.

JURISDICTION

The jurisdiction of this Court is invoked under Section 1254 of Title 28, and Section 1141 of Title 26, of the U. S. Code. The judgment sought to be reviewed was rendered on October 21, 1952.

STATUTES INVOLVED

The statutes involved are sections 181 and 3797 (a) 2 of Tit. 26 of U. S. Code, relating, respectively, to carrying on business in partnership, and defining what constitutes a partner, and also Section 23 (a)(1)(A) of Title 26 of U. S. Code, pertaining to compensation for use of property of another in business. Applicable portions of the statutes involved are set forth in the appendix, *infra*, pp. 14-15.

QUESTIONS PRESENTED

The question here presented is the validity for income tax purposes of the written agreement of petitioner and his wife, giving to the wife 45% of the profits of a business for the continued use and possession of factory buildings and machinery with which the business was carried on.

From 1922 to 1938 the business had been carried on by a husband and wife corporation, in which the wife held a controlling interest and which had been dissolved in 1938 for tax purposes and thereafter was carried on by petitioner as sole proprietor, the wife retaining control through the bona fide ownership of the buildings and machinery.

STATEMENT

The property here involved consisted of a valuable factory site at Midland, Michigan, with modern factory buildings thereon of upwards of 10,000 feet of floor space and machinery therein, originally costing upwards of $125,000 (R. 25, 26, 32). Because of the bankruptcy of the former owner it was acquired for $24,000 in 1922 (R. 26) by Roland P. Place Company, a Michigan corporation, financed with funds of petitioner's wife, Agnes A. Place (R. 27, 28) and in which she was the bona fide holder of a majority interest (Exh. 1, R. 54-56). The properties were used by that company as its only manufacturing plant until the dissolution of the corporation for tax reasons on June 30, 1938 (R. 29, 30; Exh. 5, R. 67).

Upon dissolution of the corporation the assets were distributed to petitioner and his wife in proportion to their holdings and based on depreciated values for tax purposes for 16 years (1922 to 1938) (R. 30), the wife receiving the real estate, buildings and machinery. The business thereafter was carried on by petitioner as sole proprietor, he paying compensation at first of $200 per month to his wife in the form of rent (R. 32).

The year 1938 was a depression year, and during the first six months of that year the gross sales of the corporation were only $9,874.93, and it sustained a loss of $4,202.11

(R. 103). At that time there was no business and $200 per month was all the business would stand (R. 31, 32).

By 1942 we were at war with Japan, and business had picked up, and the company was prospering. Petitioner, believing his wife entitled to a more realistic compensation for the use of her property, consulted counsel (R. 47) and, as a result, under date of May 1, 1942, a written agreement was made with her (Exh. 11; R. 21) in the form of a lease, which terminated fixed payments and gave her 45% of the profits of the business. This provision was made retroactive to January 1, 1942, and which agreement was in force until the business was sold on June 1, 1943.

The terms of the agreement were carried out by the parties and the amount of compensation accruing to Mrs. Place was paid to her as per the contract (R. 34).

Petitioner testified in substance that his wife's machinery alone was worth upwards of $25,000 at that time; that it was assessed at $23,000.00 (R. 41); that he didn't think Mrs. Place was getting a fair rental; that times had changed; property values were up; in order to be fair on the amount of interest that she had in the business because of her ownership of the property, that a 50-50 division was the way the lease should be set up, but in order to compensate for his management he thought it should be 45% and 55%, and that he considered that a fair deal (R. 33, 34). The substance of that testimony is that in his opinion a division of profits as agreed upon was a reasonable one as evidenced by the statement of the court that "We cannot rely on his own self serving testimony that the sums were reasonable in amount" (R. 107). No evidence was introduced by respondent in rebuttal of such valuations.

Mr. Place had been in the machine and manufacturing business all of his life (R. 25). He knew this property

better than anyone else. He had been operating this particular business for twenty years. He had managed this business since the first company was organized in 1922. His present connections were director of the United States Radiator Corporation and a member of its executive committee; a director of the Michigan Chemical Corporation of St. Louis, Michigan, and a director of the Midland National Bank of Midland, Michigan. His tsanding and integrity was not impugned in any manner (R. 25).

Total receipts for the years 1941, 1942 and the first five months of 1943 were $237,926.43 and $151,176.87, respectively, resulting in net profits of $35,460.19 and $37,163.81, respectively, for the two later periods, after payment of the increased rentals in question (R. 103). Reduced to percentages, total receipts had increased 16.27 times and compensation for the wife's property had increased 13.91 times, as compared to a $200 per month rental paid in 1938.

The assets were sold on May 1, 1943 for $62,400.26, of which sum $52,323.06 was in payment of the assets of Mrs. Place, and the remainder covered some machines which had been subsequently purchased by petitioner.

Petitioner contends that the agreement of 1942 (Exh. 11; R. 21) should be given full effect for tax purposes because:

1. The payments were compensation for the continued use and possession of the property, as provided in Section 23 (a)(1)(A) of Tit. 26, U. S. Code.

2. Under said agreement, petitioner and his wife were carrying on business in partnership, as provided in Sections 181 and 3797 of Tit. 26, U. S. Code.

SPECIFICATIONS OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that petitioner and his wife were not transacting business in partnership under the agreement of May 1, 1942.

2. In holding that the amounts paid to Mrs. Place were not deductible under I. R. C. Sec. 23 (a)(1)(A) as payments required to be made as a condition to the continued use or possession for purposes of trade or business of the property not owned by the taxpayer.

3. In not giving validity for income tax purposes to the agreement of May 1, 1942, made between the parties with respect to the division of profits of the business involved.

4. In holding that the maximum rentals petitioner was required to pay for the continued use and possession of the property involved was $2,400 in 1942 and $1,000 in 1943 (R. 104, 105).

5. In applying erroneous legal principles in the construction of the contract, as follows:

(a) In holding that it was necessary to determine whether the sums paid to the wife were in excess of what petitioner would have been required to pay had he dealt at arm's length with a stranger (R. 106).

(b) That there was no evidence that the wife had at any time complained that $200 per month was inadequate (R. 106), with the implication that, therefore, petitioner was not "required" to pay the sums involved.

(c) In holding that it was necessary for petitioner to prove by testimony other than his own that the division of profits was reasonable (R. 107).

(d) In giving no consideration to the testimony of petitioner that in his opinion the ratio of division of profits was fair (R. 107).

(e) In holding that the business was not a joint venture because it was not organized to carry out a specific venture as distinguished from a going business (R. 108, 109).

(f) That the agreement involved did not create a venture or partnership because the agreement was drafted in the form of a lease (R. 109).

(g) That the wife had no voice in the manner of conducting the business and was not subject to the liabilities incurred (R. 109).

6. In dismissing petitioner's petition.

REASONS FOR GRANTING CERTIORARI

Joint Venture—Conflicting opinions as to continuing business. The decision of the Court below creates a conflict on the legal principle as to whether a joint venture under the code definition can be created wtih respect to a continuing business. The opinion below stated:

> "There is no evidence that the business was organized to carry out a specific venture, or was in any way something other than a continuing business. See *Fletcher v. Fletcher,* 206 Mich. 152; 172 N. W. 436; *Chas. S. Osborn,* 22 B. T. A. 935." (R. 109)

In the United States Courts of Appeals for the Seventh Circuit[1] and the Fifth Circuit,[2] both courts found joint ventures to exist with respect to the preparation and sale of dried eggs and citrus farming business, respectively each being a continuous business.

Joint Venture—Conflicting opinions as to mutual capital. The decision of the Court below creates a conflict on the legal principle as to whether in those entities described in the code as "a syndicate, group, pool, joint venture, or other unincorporated organization" there must be one or all of the attributes of "mutual interest in capital" or "control over the profits" or "a voice in the manner of conducting the business," or being "subject to the liabilities incurred."

The learned judge of the Tax Court, C. R. Arundell, stated as follows:

> "Nor has petitioner submitted sufficient evidence of the attributes of a joint venture or partnership * * *. There was no mutual interest in capital and no mutual sharing of losses * * *. The wife had no control over the profits, no voice in the manner of conducting the business and was not subject to the liabilities incurred." (R. 109)

These findings have the effect of holding that one or more of the named attributes are necessary in one or all of the entities above mentioned.

We believe that none of them are necessary to create any of the entities mentioned. The decision is in conflict with the decision of the Seventh Circuit in the case of

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[1] *Rupple v. Kuhl*, 177 Fed. (2d) 823.

[2] *L. W. Tilden Inc. v. Comm.*, 192 Fed. (2d) 704.

Rupple v. Kuhl,[3] in which none of the mentioned attributes existed. In that case a wife advanced moneys to her husband with which to buy a one-third interest in a partnership and for which she was to be paid 50% of her husband's profits in the enterprise. On the part of the wife there was no mutual interest in capital, no voice in the manner of conducting the business, and she was not subject to any liabilities incurred. The trial court pointed out that—

> "the statute provides no limitation whatever as to the property interests which may be the capital of a joint venture so long as it is a business, financial operation or venture."

It is not necessary that a partner share in losses as well as profits. He may share in profits or losses or both.[4] The husband was a partner in the other enterprise but, as between him and his wife, they were joint venturers.

The parties had the right to cast the business in any form they chose, and are not required to operate it in the form most advantageous to the Government taxwise.[5]

Payments for use of property—Conflicting opinions as to weight of evidence as to reasonableness. The decision of the Court below creates a conflict with the decision of the United States Court of Appeals for the Tenth Circuit in the case of *A. & A Tool & Supply Company v. Commissioner*, with respect to the presumption to be given to the

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[3] *Rupple v. Kuhl*, 177 Fed. (2d) 823. See also to same effect, *Harry Klein v. Commissioner*, 18 T. C. (No. 98, decided July 25, 1952) involving investment by a wife in her husband's share of a partnership operating a women's clothing business.

[4] *Commissioner v. Culbertson*, 337 U. S. 733, 741; *Saward v. Saward*, 119 Misc. N. Y. 676, 197 N. Y. Supp. 123.

[5] *L. W. Tilden Inc. v. Comm.*, 192 Fed. (2d) 704, 708.

determination of facts by the Commissioner and the weight to be given uncontradicted testimony of the taxpayer.[6]

Notwithstanding petitioner's unimpeached testimony of the reasonableness of the sums agreed to be paid to his wife (R. 33, 34) and of the value of the machinery (R. 41), the learned tax Judge held:

> "Petitioner has not shown either that the sums paid or some other sum in excess of $200 per month was reasonable, nor has he shown the value of the properties at the time the increased sums were paid. We cannot rely on his own self-serving testimony that the sums were reasonable in amount, or that the machinery was worth $25,000 in 1942" (R. 107).

Payments for Use of Property—Conflict as to standard of reasonableness. The decision of the Court below is in conflict with the decision of the Tax Court of the United

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[6] *A. & A. Tool & Supply Co. v. Comm.*, 182 Fed. (2d) 300, 304, where, in connection with taxpayer's testimony regarding reasonable rental, the court stated:

> "The presumption that the Commissioner's determination is correct is one of law; it is not evidence and may not be given weight as such. *N. Y. Life Ins. Co. v. Gamer*, 303 U. S. 161, 171, 58 S. Ct. 500, 82 L. Ed. 726, 114 A. L. R. 1218. When evidence is introduced by the taxpayer sufficient for the Tax Court to base a finding contrary to the determination, the presumption disappears. *Crude Oil Corp. of Am. v. Commissioner*, 10 Cir., 161 F. 2d 809; *Mayson Manufacturing Co. v. Commissioner*, 6 Cir., 178 F. 2d 115, 121. The Tax Court * * * was created to afford a taxpayer an independent forum where he could be heard speedily, equitably and impartially on a tax assessment which he thought had been improperly levied or assessed. Its function is to weigh evidence on matters properly before it and make findings of fact thereon, * * *. It may not arbitrarily discredit and disregard unimpeached, competent and relevant testimony of a taxpayer which is uncontradicted. There was sufficient evidence as to this item to overcome the presumption of correctness of the Commissioner's determination and the Tax Court should not have disregarded it."

States in the case of *Imerman v. Commissioner*,[7] wherein it was held that the standard of "reasonable allowance" in Section 23 (a)(1)(A) of Internal Revenue Code did not apply to rentals or other payments required to be made as a condition for the continued use or possession for purposes of trade or business of property to which the taxpayer has not taken, or is not taking title, or in which he has no interest.

The cases cited in the opinion as exceptions to the general rule and those cited by respondent in connection with this point are all cases in which the bona fide ownership of the property involved is challenged on grounds such as being a sham for the purpose of evading taxes,[8] or gifts with retained control,[9] or domination by one party over another as by a corporation over its subsidiary,[10] or transactions where no true business purpose is accomplished.

In the present case a true business purpose was accomplished by resolving the terms under which the property could be used by the husband, and in providing for her the compensation which the parties in good faith believed she was entitled to receive.

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[7] *Imerman v. Comm.*, 7 T. C. 1030.

"*The code does not limit deductions for rental payments* to a 'reasonable allowance' as in the case of salary or compensation, but at the same time the code does not preclude the respondent from examining the facts relating to such payments for the purpose of *determining their true character and from disallowing deductions claimed as rents where the payments were of a character not permitted as deductions by the code.* Cf. *Chicago Shipping & Storage Co.*, 15 B. T. A. 431; affd. 47 F. (2d) 539; *Orange & Domestic Laundry Co.*, 6 B. T. A. 646." (Italics ours.)

[8] *Stanwick's Inc. v. Comm.*, 15 T. C. 556, affd. 190 F. (2d) 84.

[9] *White v. Fitzpatrick*, 193 Fed. (2d) 398.

[10] *Hightower v. Comm.*, 187 Fed. (2d) 535.

We believe that in cases of dealings between members of a family group where, as here, the bona fide ownership of the property involved is not challenged, the compensation for its use should not be limited to a sum which they might be able to prove was what they could get from a stranger, but their good faith judgment of the amount to be paid should be sufficient providing the agreement is carried out according to its terms.

Question of Intent—Substance over form. We believe that the question of intent to transact business as a joint venture, pool or group, is to be deduced from the things required to be done by the agreement, [11] and the carrying out of the contract by the parties,[12] and that drafting the agreement in form of a lease is not decisive. Mere words of agreement do not necessarily create or destroy an agreement that the law asserts is a partnership.[13] Also, that substance controls over form for tax purposes.[14]

CONCLUSION

We believe it to be of paramount national importance that the findings and opinion of the courts below be reviewed by this court to the end that members of family groups having the bona fide ownership of separate property may be better informed on what limitations for tax purposes are imposed on them when joining their property in business.

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[11] *Lindley—Partnership*, 10th Ed. 44. "People intend the consequences of their own acts."

[12] *Commissioner v. Culbertson*, 337 U. S. 733, 741, 742.

[13] *N. B. Drew*, 12 T. C. 5; *Saward v. Saward*, 119 Misc. N. Y. 676, 197 N. Y. Supp. 123.

[14] *Commissioner v. Court Holding Co.*, 324 U. S. 331; *Griffiths v. Comm.*, 308 U. S. 355.

Therefore, we respectfully request that Writ of Certiorari issue to the United States Court of Appeals for the Sixth Circuit for a review of this case in this Court.

Respectfully submitted,

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Dated: December 5, 1952.

APPENDIX

The pertinent provisions of the Internal Revenue Code and regulations are as follows:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * * *and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.*" (Italics ours.)

Sec. 181, 26 U. S. C. (53 Stat. 69):

Partnership not taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Tit. 26 U. S. C., *Sec. 3797. Definitions:*

When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—* * * *

Partnership and partner. The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization. through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

REGULATIONS 111:

Sec. 29.3797-4. Partnerships.—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, *group, pool, joint venture,* or other unincorparted organization which *carries on any business,* financial operation, or venture, and which is not, within the meaning of the code, a trust, estate, or a corporation. * * * (Italics ours.)